3RD QUARTER REVIEW AND OUTLOOK

Cautious Observations

- The timing and pace of reopening the economy will have significant ramifications on the level of defaults and bankruptcies that ensue. Rising infections this fall further complicates any attempt at prognosticating near-term developments.
- Second and third-order ancillary effects of the pandemic remain elusive, particularly consumer behaviors and return to 'normalcy' and the ultimate recovery in the labor market. We expect the recovery process to be slow and choppy as there remains considerable uncertainty associated with how cautious households and businesses will be in the upcoming months and years. The initial economic shock is disinflationary, but the aggressive policy response (both monetary and fiscal) to offset it will gradually tilt the balance in an inflationary direction.
- Absent the Federal Cares Act, disposable income in the US would have fallen by 8% during the CoVid crisis. Instead, income surged by 11% year-over-year. The $600 per week unemployment supplement expired July 31st but is expected to be renewed after the election, likely in a smaller increment. State and local government rescue funds are a major point of contention and are mostly depleted.

Constructive Observations

- U.S. total monetary/fiscal stimulus is $9.5 trillion already (almost 6 months of GDP). To put this in perspective, the more dire GDP forecasts log a 9% contraction for the year while Bloomberg's average of 70 economists registers a 4.5% contraction for 2020. On a $20 trillion dollar economy, that is a drag of somewhere between $1.2T and $2T. The fiscal response alone to date is near $3T with another $1.8 trillion being negotiated by Treasury Secretary Mnuchin and House Speaker Pelosi.
- Markets seem to be pricing in pro-growth D-sweep considerations including large fiscal stimulus, eliminating tariffs, improved trade relations while discounting anti-growth D-sweep considerations including higher taxes, increased regulations, and soaring deficits.
- We expect the global 'Manhattan Project' style race across bio-innovation industries for testing, treatments and vaccination should yield results sometime in Q1 of 2021.

Outlook

Policy and the pandemic will continue to drive markets in the short-term and keep volatility elevated. Beyond the near-term volatility, the weight of the evidence tells us that unprecedented levels of monetary and fiscal stimulus will provide a tailwind to risk assets.

ECONOMIC OVERVIEW

During the third quarter, US and global economies continued to rebound from the pandemic-induced recession which began in February. Continued fiscal and monetary stimulus from governments and central banks globally have dampened the economic impact, allowing businesses to stabilize and begin the recovery process toward normalization. However, the return to "normal" for many countries and industries comes with a level of uncertainty that is much higher relative to any other time in recent history due to the uncertain nature and path of the virus.

The Federal Reserve Bank of Atlanta's GDPNow model, a running estimate of growth during the quarter, projects a significant rebound of +34.6% growth for the 3rd quarter.

The U.S. Consumer

The unemployment rate peaked in April at 14.7%, declined to 11.1% in June and fell further to 7.9% in September. Despite the improvement, the jobless rate is well above February's generational low of 3.5%. The trend of weekly Jobless claims has continued to decline, while the level remains higher than any point during the past seven recessions.

S&P Case-Shiller US National Home Price index showed home prices up 4.8% y/y in July and up 0.8% vs. June, reaching a new all-time high. An all-time high in pending home sales is supportive of continued home price appreciation. Pending sales are up 24% y/y and jumped 8.8% m/m in August, (beating expectations of 3.1%) fueled by low interest rates and an exodus from metropolitan areas during the pandemic.

Consumer confidence rebounded in September, with its largest gain in over 17 years. The Conference Board's Consumer Confidence index increased 17.96% to 101.8, exceeding the median forecast of 90. While confidence has improved, it remains below pre-CoVid 19 highs.

Retail sales jumped 1.9% in September and 13.5% for the quarter, more than reversing the 7.1% drop in the previous quarter. The reopening of the economy and a strong fiscal stimulus early in the pandemic helped retail sales recover their pre-recession peak as early as June. On a year-over-year basis, retail sales increased 3.6%, the fastest pace since February, and in line with the average annual gain over the past five years.

The Federal Reserve

In August, the Fed adopted usage of an average inflation target. As a result, it will strive to achieve inflation slightly higher than 2% so that the average over time is 2%. Additionally, the Fed has altered its stance on maximum employment with less emphasis on the historically inverse relationship between employment and inflation. Employment levels can function at or above maximum estimates without necessarily raising concerns of higher inflation.

EQUITY MARKETS

U.S. Equity

Despite a choppy September, the S&P 500 Index recouped losses from the first half of the year, ending the third quarter +5.6% year-to-date. Without the contribution of the so-called "FANMAG" stocks (Facebook, Amazon, Netflix, Google, Apple and Microsoft) the S&P 500 would actually have been down 3.6% for the year at the three-quarter mark of 2020.

As has been the case for some time, growth indices dramatically out-performed value indices across the market capitalization spectrum. Small caps (+4.9%) and mid-caps (+7.5%) produced solid returns for the quarter, but lagged the FANMAG heavy S&P 500 (+8.9%)

International and Emerging Market Equity

International equity markets extended their recovery from lows reached in March as investors expressed confidence in an economic rebound from the effects of the global coronavirus pandemic. For the quarter, developed international markets gained 4.8% while emerging markets surged 9.6%. As was the case with US markets, growth substantially outperformed value overseas for the quarter and year to date periods.

FIXED INCOME MARKETS

Treasury prices again did not change much over the quarter (+0.2%) after experiencing massive price increases earlier in the year due to the flight to quality. The Federal Reserve supported the Treasury market with an announcement during the quarter that adopted a new flexible average inflation target. To achieve this, the Fed now expects to leave the policy rate at near-zero until labor market conditions have reached levels consistent with the assessments of maximum employment and for inflation to moderately exceed 2% for some time.

Spreads were again tighter across all credit sectors during the quarter as investors continued to look for yield due to increased optimism about the economic recovery. The benchmark Bloomberg Aggregate Bond Index returned 0.6% for the quarter. Investment grade corporates (+1.5%), high yield (+ 4.6%), and emerging market debt (+2.3%) posted solid returns.